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TAYLOR
ENERGY COMPANY

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August 21, 1997

Minerals Management Service
Attn: Rules Processing Team
Mail Stop 4700
381 Elden Street
Herndon, VA 20170-4817

Re: Comments on the Notice of Proposed Rule Making Oil Spill Financial Responsibility for Offshore Facilities 30 CFR Part 253; RIN 1010-AC33 Oil Pollution Act of 1990 Section 1016, as amended (33 U.S.C. 2716)

Gentlemen:

Taylor Energy Company appreciates the opportunity to comment on the Minerals Management Service's (MMS) proposed regulation entitled "Oil Spill Financial Responsibility for Offshore Facilities", 62 FR 14052 (March 25, 1997). As a company which operates exclusively on the Outer Continental Shelf, we will be significantly affected by the outcome of this rule making. We endorse the comments of the American Petroleum Institute (API), the Independent Petroleum Association of America (IPAA), and the Offshore Operators Committee (OOC) and wish to provide the following additional comments.

1. Direct Action: In Section 253.41(d), the proposed rule should mirror the statutory language word for word regarding the circumstances under which a guarantor is subject to direct action. Insurance companies will be hesitant to certify if they believe the regulation broadens the statutory language.

2. Joint and Several Liability: Section 253.11 of the proposed regulation requires that the "designated applicant" certify Oil Spill Financial Responsibility (OSFR) for all the "responsible parties" owning an interest in a lease. Typically, each co-owner in a lease insures their own risks as deemed appropriate. The typical joint operating agreement states how costs will be shared in general, but does not specifically address oil spills and the resulting liability. Although joint and several liability has been a concern of the insurance industry for years under Outer Continental Shelf Lands Act's (OCSLA) OSFR certification, the increase in limits of liability from $35 million to $150 million coupled with the expanded definition of damages raises the joint and several issue to new heights.

The Oil Pollution Act of 1990 (OPA '90) states that all responsible parties in a lease are liable. It may be commercially unacceptable for an insurance company to certify 100% of the lease, while insuring a portion of the lease, and collecting premiums only for that portion. The requirement that there be only one designated party for each lease is an administrative convenience imposed for the benefit of the MMS, and as such goes far beyond the intent of the OPA '90. Each responsible party should be required to demonstrate OSFR for their ownership interest in each lease.

3a. Terminology: With reference to the proposed regulation, several definitions need to be resolved. The intent of the proposal is to permit the MMS to track OSFR compliance by lease. (Reference Section 253.20 and proposed MMS Form 1021.) Some of the older leases contain more than one block, and over the years, blocks have been reassigned to multiple companies. There is no incentive for companies who lack any common financial interest to designate one company as the designated party for demonstrating OSFR. Some leases contain portions of units. It is unlikely that the operator of the unit and the operator of the surrounding lease acreage will be the same party, and the financial interests of the parties may be diverse. The MMS should consider more flexibility in the proposed system of tracking OSFR compliance by recognizing leases, units and blocks where appropriate. This will be necessitated for state waters, which fall completely outside of the federal lease numbering scheme.

3b. Section 253.3 of the proposed regulation defines a "covered offshore facility" (COF) as (1) a structure, group of structures, a well, equipment, pipeline, or device (2) used for exploring for, drilling for, producing, storing, handling, transferring, or processing oil that (3) has a worst case oil spill discharge potential of more than 1,000 bbls. of oil (as long as its not in an "environmentally sensitive area") and (4) is either (a) located seaward of the line of ordinary low water along the coast in direct contact with open sea or (b) is located in coastal inland waters seaward of the coastline which is not in direct contact with the open sea.

As such, this definition is much too vague to be of practical use. For example, if you have a lease with a platform in the Gulf of Mexico with two wells which have a worst case oil discharge potential of 600 bbls. each; two wells which have a worst case oil discharge potential of 1,100 bbls each; and a 1,000 bbl. oil tank, how many COFs do you have on the lease? Do you have an oil discharge potential of 4,400 bbls. at one COF? If you do not aggregate, do you have three COFs (two wells at 1,100 bbls. each, and one tank)? If you have three COFs, is the worst case oil spill potential for the lease 1,100 bbls? What happens when you have a flowline crossing the lease line? Is it subdivided into two

COFs? Since the amount of OSFR is based upon the worst case potential oil spill from a COF, the definition of a COF is essential. The penalty regime for non-compliance is tied directly to the number of COFs.

In addition to the confusion posed by the definition of a COF, the definition of "facility" under the final regulation for Response Plans for Facilities Located Seaward of the Coast Line (30 CFR Parts 250 and 254) is different. "Facility" under Part 254.6 does not include wells, yet this definition is used to determine the worst case oil spill potential for OSFR purposes. For purposes of spill plans, the worst case spill scenario includes the volume of oil from an uncontrolled blowout of the highest productive well at the facility.

The proposed regulation does not address the status of a well about to be spudded. The designated applicant does not know if the well will eventually qualify as a COF. It could be a dry hole, a gas well, or an oil well with a worst case oil spill potential below 1,000 bbls.

In regard to exceptions to the 1,000 barrel worst case oil spill potential threshold, a procedure should be developed permitting a company to request a determination from the MMS concerning the environmental sensitivity of a particular location. As proposed, the MMS could retroactively declare a site a COF.

3c. The definition of a "worst case oil spill" from a covered offshore facility is vague and inappropriate. The OSFR regulation points to the final regulations for Response Plans for Facilities Located Seaward of the Coastline published in the March 25, 1997 Federal Register.

Section 254.47 of that regulation states: *You must calculate the volume of oil of your worst case discharge scenario as follows:*

(a) for an oil production platform facility, the size of your worst case discharge scenario is the sum of the following: (1) the maximum capacity of all oil storage tanks and flow lines on the facility; (2) the volume of oil calculated to leak from a break in any pipelines connected to the facility considering shut down time, the effect of hydrostatic pressure, gravity, frictional wall forces and other factors; and (3) the daily production volume from an uncontrolled blowout of the highest capacity well associated with the facility. In determining the daily discharge rate, you must consider reservoir characteristics, casing/production tubing sizes, and historical production and reservoir pressure data. Your scenario must discuss how to respond *to this well flowing for 30 days as required by Section 254.26(d)(1).*

(b) For drilling operations, a company's "*worst case discharge scenario is the daily volume possible from an uncontrolled blowout . . . Your scenario must discuss how to respond to this well flowing for 30 days as required by Section 254.26(d)(l).*

(c) Similar language is used for pipelines using the highest measured flow rate during the preceding 12-month period.

Section 254.26(d) requires that a company identify equipment, personnel, cleanup supplies, estimate procurement time, deployment time, and state the effective daily recovery capacity in adverse weather conditions. Twenty percent of rated equipment capacity is to be used unless evidence to the contrary is presented and accepted by the MMS. <u>The spill plan regulation was designed to err on the side of conservatism.</u> <u>Is it equitable to base OSFR on the presumed 500% redundancy required by the spill plan?</u>

3d. The proposed definition of "coastline" is a topic of debate and we incorporate the position of IPAA, OOC and API on this issue. If the MMS is to effectively enforce this regulation and the industry comply with it, we must have a "bright line test". Insurance companies will be extremely hesitant to certify properties if in fact, doubt exists whether the statute is applicable to a particular property.

3e. Problems posed by several undefined terms in the proposed regulation were described by Talley & Associates, P.C., a contractor employed by the MMS to evaluate the proposed rule. We incorporate their comments concerning definitions by reference.

4. <u>Form of Security:</u> For self insurance, the proposed regulations do not explain how the pledged unencumbered assets will be secured by the Government. Will the pledge place the Government in a first priority position ahead of other claimants when no debt has accrued at the time assets are pledged?

   Property, plant and equipment are not as useful for collateral as current assets because they lack the portability and liquidity of financial assets. At a minimum, financial instruments should be added to assets which may be pledged. (Reference Section 253.26.)

5. <u>Form 1019:</u> The insurance certificate form (MMS-1019) expands the certification beyond that which is required by the proposed regulation. On page 2 of the form, a "check the box" option is provided. Both options reference "All offshore facilities". The proposed regulation only requires that "covered offshore facilities" be insured, not every type and

size facility on a lease. Insurance companies will not sign a certificate form that deviates so significantly. Form 1021, titled "Lease Listing", does not have a place for describing state water leases.

6. Thirty-Day Notice: The MMS proposes that 30 days notice be given before a COF is added or dropped from the schedule on Form 1021. In purchase/sale situations, this may not be practical. Unforeseen circumstances may prevent the transaction from being completed. Provision should be made for reporting a planned transaction with a follow-up report. This will provide sufficient time for the MMS to ascertain if the acquiring company has demonstrated OSFR.

   In similar manner, if the MMS decides that every new well spudded is to be treated as a COF until proved otherwise, operators will have to give notice 30 days before spud date, and if it is a dry hole, provide 30 days notice before deleting the "COF" that never really existed.

7. Financial Impact: The Oil Pollution Act of 1990 was hastily enacted without due deliberation of alternative means of achieving the underlying goals. Neither interaction with our complex system of state and federal law, nor the commercial reasonableness of the legislation was given sufficient consideration. The OPA '90 was drafted with huge corporations in mind; corporations with wealth greater than many countries in the world. The OPA '90 expanded the scope of damages; requires that a responsible party advertise for claimants to bring action in the event of a spill; and does not preempt state law. For all of these reasons, and others, the commercial reasonableness of the legislation has been problematic.

   A central goal of the legislation is to protect the public by assuring oil spill pollution will be cleaned up and resulting damages will be compensated.

   Oil companies have already fully funded the Oil Spill Liability Trust Fund (the Fund). If the resources in the Fund were depleted, the industry would be required to replenish the Fund. Thus, the public has a guarantee from the industry that any spill will be cleaned up. With a few exceptions for very large corporations, the OPA '90 and the proposed regulation seek a guarantee from the global insurance industry that (1) the Fund will not be called upon; (2) sufficient funds will be available to compensate damages resulting from a spill; and (3) the government will not be called upon to fund repair of natural resources, except potentially in the extraordinary circumstance of a huge spill.

The MMS has not adequately considered the financial impact of this proposed rule. For instance, when an oil company calculates the economically recoverable reserves from a lease, the answer to the calculation will vary based upon ownership. A large company able to self certify for OSFR will have lower lease operating expense than a company which is required to purchase a certain amount of insurance under the proposed rule. The MMS is implementing the final supplemental bonding requirements as published in the May 22, 1997 Federal Register in similar fashion. The combined effect of these two rules is to raise lease operating costs for smaller companies, which will lower economically recoverable reserves, and federal royalties collected.

Smaller oil companies have historically fulfilled two important functions for the industry. First, they provide a market for major integrated companies to monetize their developed/partially developed reserves so that they can reinvest funds into new projects with higher risk/return profiles more suitable for the level of expertise and staffing level in their market niche. Second, smaller companies tend to have less overhead, thus extending the economics of reserve recovery for the benefit of the U.S. and the MMS in terms of royalty.

In addition, smaller reservoirs which have been bypassed by the majors because they did not meet their investment thresholds, have been subsequently drilled by independent oil companies. This rule will increase rapidly rising drilling costs further, since OPA '90 insurance will cost more than Outer Continental Shelf Lands Act (OCSLA) coverage.

There may be insufficient capacity in the global insurance market to underwrite significant additional coverage without substantially higher prices due to supply and demand. Because the OPA '90 broadens the concept of damages, a great deal of uncertainty exists. Without claims history, insurance companies can not efficiently price their product. At a minimum, broader potential damages under OPA '90, demand higher insurance premiums compared to certification under OCSLA.

It is essential that the MMS determine how much insurance the industry will be required to purchase as a result of this rule and also determine if sufficient capacity exists in the marketplace to fulfill its requirements. The current regulations promulgated March 19, 1979 (44 FR 16860), pursuant to the OCS Lands Act Amendments of 1978 (OCSLAA) will automatically be repealed in accordance with section 1016(h) of the OPA '90 upon enactment of the new regulation. Will the industry be able to comply?

On page 22 of the Determination of Effects of Rules distributed at the June 5th, 1997 public hearing in New Orleans to discuss the proposed regulation, the MMS states that the additional cost to the industry resulting from this new rule will be $105,000 per year. This is an extremely low estimate of the financial impact that will result from this new rule. For the reasons stated herein, the Unfunded Mandates Reform Act of 1995, 2 U.S.C. 1502 may be applicable.

A responsible party that operates an offshore facility without providing evidence of OSFR is in violation of the OPA '90, and is subject to civil penalties of up to $25,000 per day and/or court order ceasing operations as provided at Section 4303 of the OPA '90. The insurance industry has not stated that they will provide OPA '90 coverage, nor determined to whom they will offer the coverage, nor determined the cost of insurance for OPA '90 policies. A Takings Implication Assessment should be prepared pursuant to Executive Order 12630, Governmental Actions and Interference with Constitutionally Protected Property Rights since a $25,000 per day civil penalty ($9,125,000 per year) or order to cease operations potentially could bankrupt some small companies and result in loss of their primary assets.

8. Conclusion: The Minerals Management Service is to be commended for its efforts to implement a poorly drafted piece of legislation. Under Executive Order 12777 issued October 18, 1991, by the Office of Management and Budget (OMB), the Minerals Management Service is responsible for issuing regulations to ensure that responsible parties can pay for cleanup of oil-spill pollution from offshore facilities and any resulting damages by requiring them to establish and maintain evidence of Oil Spill Financial Responsibility. The law also requires MMS to find acceptable methods of evidencing Oil Spill Financial Responsibility. The MMS cannot at this time state how many companies will qualify for self insurance under the proposed rule, nor how much insurance the oil industry will be required to purchase (ignoring the fact that OPA '90 insurance coverage does not exist in the market at this time), nor what percentage of the global insurance market's capacity will be consumed as a result of this rule making. Therefore, the proposed rule does not carry out the law.

Sincerely,

TAYLOR ENERGY COMPANY

Timothy C. Woods

Timothy C. Woods
Chief Financial Officer

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